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SUBJECT: BANGLADESH ECONOMY LOOKING UP?

REF: DHAKA 485

SUMMARY

¶11. (SBU) Recent upsurges in Bangladesh's export earnings, remittances and Government of Bangladesh (GOB) revenues point to an economic rebound in the last half of the country's fiscal year, which runs from July 1 to June 30. This is good news after the shocks of the first half of the year, including a devastating cyclone and two floods. International experts estimate that Bangladesh's economy may grow by 6 percent this fiscal year, up from projections several months ago of 5.5 percent growth. Challenges remain, however, including inflation, food security and heavy subsidies, all of which put a strain on government coffers. Bangladesh's Caretaker Government has some plans to address the challenges, but it has limited maneuvering room.

GOOD NEWS - EXPORTS, REMITTANCES, REVENUE

¶12. (SBU) Strong growth in exports and remittances in the last few months has boosted Bangladesh's overall growth prospects. Officials have reported that Bangladesh's export earnings increased by 12.4 percent in the first nine months of FY 2008. (In the first six months of FY 2008, exports grew by less than three percent.) Exports of ready-made garments (RMG) drove this growth. According to the World Bank, RMG exports from Bangladesh remain strong as a result of three factors:

--consumers in the United States and elsewhere buying low-cost apparel of the type produced in Bangladesh;

--increasing production costs in China, which makes Bangladesh-made garments more cost-competitive; and

--appreciation of the Indian rupee, which also makes Bangladeshi garments more competitive.

¶13. (SBU) Remittances from Bangladeshi workers overseas continue to set records. According to the International Monetary Fund (IMF), in March alone workers sent USD 850 million back to Bangladesh, a monthly all-time high. Experts predict that remittances could top USD 8 billion in FY 2008, up from slightly less than USD 6 billion in FY 2007.

¶14. (SBU) Another bright spot is GOB revenue collection. In a

briefing for international donors, the IMF reported the Government of Bangladesh (GOB) is expected to increase tax revenues to 9 percent of Gross Domestic Product (GDP), up from 8.3 percent in FY 2007. While some of the progress in tax collection is due to the Caretaker Government's anti-corruption campaign, which has cracked down on concealed wealth, the IMF noted the GOB has also improved some tax collection practices, including acceptance of self-assessed tax documentation and measures to increase the number of taxpayers.

¶5. (SBU) These factors have led the IMF and others to raise their overall GDP growth projections by 0.5 percent or more. According to the IMF, Bangladesh's economy grew by 6.2 percent in FY 2007. Early this fiscal year, experts predicted the economy might grow by as much as 6.5 percent. In the wake of Cyclone Sidr and severe monsoonal flooding in 2007, however, economists revised their growth estimates to 5.0 or 5.5 percent. Following recent good news on export earnings and remittances, Bangladesh Bank (the nation's central bank) revised its growth estimate for FY 2008 to 6.2 percent. IMF officials said this estimate was likely a bit high, but acknowledged that 6 percent growth was possible.

BAD NEWS - INFLATION, FOOD SECURITY, SUBSIDIES

¶6. (SBU) Challenges to economic growth remain, however. Inflation is hitting Bangladesh's citizens - 84 percent of whom subsist on less than two dollars a day - hard. The IMF estimates the annual inflation rate will hover around 10 percent by the end of FY 2008. High prices for food worldwide have exacerbated Bangladesh's recent food shortages, caused by Cyclone Sidr and two floods (reftel). Farmers are now harvesting the nation's largest rice crop of the

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year, which is expected to be good, but there is no sign yet of decreasing prices. High prices are one of the main reasons for current public dissatisfaction with the Caretaker Government.

¶7. (SBU) Food security is a long-term threat to Bangladesh. Undernourishment as a result of a lack of adequate nutrition and food shortages affect more than one-third of this nation's approximately 150 million people. The GOB has programs to distribute food to these vulnerable groups and plans to expand these programs in the FY 2009 budget. According to the World Food Program, however, these programs provide inadequate amounts of rice and other food to poor families.

¶8. (SBU) Another major challenge to the GOB's ability to foster economic growth is its subsidy program. The GOB heavily subsidizes fuel and fertilizer. While these subsidies have buffered Bangladeshis from the worst of high petroleum prices worldwide, the GOB pays tens of millions of dollars a month to offset the cost of fuel subsidies. Government officials estimate subsidies will cost the GOB close to USD 3 billion in FY 2008. As a first step to adjusting some of these subsidies, the Caretaker Government recently doubled the price of compressed natural gas (CNG), which fuels most buses and auto-rickshaws. The Finance Adviser last week said publicly that the government had no alternative but to increase fuel prices in Bangladesh. At the same time, the Caretaker Government plans in FY 2009 to better target subsidies, particularly for farmers, to mitigate price increases for key constituencies, including the poor.

COMMENT

¶9. (SBU) Bangladesh's economy continues to demonstrate its ability to rebound from adversity, whether it is caused by natural disasters or poor governance. Bangladesh's human capital, at home and abroad, continues to drive economic growth. In addition, Bangladesh's central bank is reluctant to raise interest rates to fight inflation. Bankers and investors have claimed over the last year that high interest rates have discouraged investment, and they have called on the GOB to lower interest rates. The technocrats that lead the Caretaker Government well understand the threats to continued growth, but have limited capacity to tackle these problems. For example, though the GOB desperately needs to improve

its subsidy program and to raise prices in certain areas, public tolerance for further price hikes, particularly in the current inflationary environment, is low.

Moriarty